

**Deaconess Women's Hospital
of Southern Indiana, LLC
d/b/a The Women's Hospital**

2007 Audit Results



Deaconess Women's Hospital of Southern Indiana, LLC
d/b/a The Women's Hospital

Accountants' Report and Financial Statements
December 31, 2007 and 2006

**Deaconess Women's Hospital of
Southern Indiana, LLC
d/b/a The Women's Hospital
December 31, 2007 and 2006**

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Independent Accountants' Report

Board of Managers
Deaconess Women's Hospital of
Southern Indiana, LLC
d/b/a The Women's Hospital
Newburgh, Indiana

We have audited the accompanying balance sheets of Deaconess Women's Hospital of Southern Indiana, LLC d/b/a The Women's Hospital as of December 31, 2007 and 2006, and the related statements of operations, members' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Women's Hospital as of December 31, 2007 and 2006, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

BKD, LLP

February 13, 2008

**Deaconess Women's Hospital of
Southern Indiana, LLC
d/b/a The Women's Hospital**

**Balance Sheets
December 31, 2007 and 2006**

Assets

	2007	2006
Current Assets		
Accounts receivable, net of allowance for uncollectible accounts; 2007 - \$466,436, 2006 - \$491,024	\$ 7,419,378	\$ 6,722,122
Supplies	274,150	270,305
Prepaid expenses and other	199,988	632,957
Total current assets	<u>7,893,516</u>	<u>7,625,384</u>
Property and Equipment, At Cost		
Leasehold improvements	942,472	378,054
Equipment	10,210,207	9,373,334
Construction in progress	56,150	107,244
	<u>11,208,829</u>	<u>9,858,632</u>
Less accumulated depreciation	<u>(5,654,245)</u>	<u>(4,559,034)</u>
	5,554,584	5,299,598
Other Assets		
Physician note receivable	-	20,158
Other assets	124,893	98,781
Goodwill	295,800	-
	<u>420,693</u>	<u>118,939</u>
Total assets	<u>\$ 13,868,793</u>	<u>\$ 13,043,921</u>

Liabilities and Members' Equity

Current Liabilities		
Checks in process of clearing	\$ 77,501	\$ 327,420
Line of credit	-	1,343,274
Current maturities of long-term debt	917,744	631,604
Accounts payable	2,190,674	1,829,022
Accrued expenses	1,533,592	1,493,528
Total current liabilities	<u>4,719,511</u>	<u>5,624,848</u>
Long-Term Debt	<u>2,110,258</u>	<u>2,046,006</u>
Members' Equity		
Contributed capital	3,500,000	3,500,000
Accumulated earnings	3,539,024	1,873,067
Total members' equity	<u>7,039,024</u>	<u>5,373,067</u>
Total liabilities and members' equity	<u>\$ 13,868,793</u>	<u>\$ 13,043,921</u>

**Deaconess Women's Hospital of
Southern Indiana, LLC
d/b/a The Women's Hospital**

**Statements of Operations
Years Ended December 31, 2007 and 2006**

	<u>2007</u>	<u>2006</u>
Revenues		
Net patient service revenue	\$ 49,517,529	\$ 41,703,557
Other	1,364,028	928,609
Total revenue, gains and other support	<u>50,881,557</u>	<u>42,632,166</u>
Expenses and Losses		
Salaries and wages	16,189,242	14,400,681
Employee benefits	4,546,695	3,547,909
Medical supplies	3,678,560	3,245,648
General supplies	924,336	796,988
Purchased services and professional fees	9,470,441	8,600,091
Rent expense	3,350,324	3,375,445
Depreciation and amortization	1,183,218	1,180,676
Interest expense	266,257	281,871
Provision for uncollectible accounts	1,236,841	845,481
(Gain) loss on disposal of equipment	4,608	(24,579)
Other	2,847,308	2,378,430
Total expenses and losses	<u>43,697,830</u>	<u>38,628,641</u>
Operating Income	<u>7,183,727</u>	<u>4,003,525</u>
Other Income		
Interest income	19,140	14,717
Other	23,802	12,468
	<u>42,942</u>	<u>27,185</u>
Net Income	<u>\$ 7,226,669</u>	<u>\$ 4,030,710</u>

**Deaconess Women's Hospital of
Southern Indiana, LLC
d/b/a The Women's Hospital
Statements of Members' Equity
Years Ended December 31, 2007 and 2006**

	Contributed Capital	Accumulated Earnings	Total
Balance, January 1, 2006	\$ 3,500,000	\$ 827,249	\$ 4,327,249
Distributions to members	-	(2,984,892)	(2,984,892)
Net income	-	4,030,710	4,030,710
Balance, December 31, 2006	3,500,000	1,873,067	5,373,067
Distributions to members	-	(5,560,712)	(5,560,712)
Net income	-	7,226,669	7,226,669
Balance, December 31, 2007	<u>\$ 3,500,000</u>	<u>\$ 3,539,024</u>	<u>\$ 7,039,024</u>

**Deaconess Women's Hospital of
Southern Indiana, LLC
d/b/a The Women's Hospital**
Statements of Cash Flows
Years Ended December 31, 2007 and 2006

	2007	2006
Operating Activities		
Net income	\$ 7,226,669	\$ 4,030,710
Items not requiring (providing) cash		
Depreciation and amortization	1,183,218	1,180,676
Provision for uncollectible accounts	1,236,841	845,481
(Gain) loss on sale of property and equipment	4,608	(24,579)
Changes in		
Patient accounts receivable	(1,934,097)	(2,358,997)
Supplies	(3,845)	(6,396)
Accounts payable and accrued expenses	401,716	696,379
Other assets	406,857	(96,513)
Net cash provided by operating activities	<u>8,521,967</u>	<u>4,266,761</u>
Investing Activities		
Proceeds from sale of property and equipment	-	74,352
Payment for business acquisition	(230,487)	-
Purchase of property and equipment	(1,067,928)	(599,696)
Proceeds received on physician note receivable	20,158	225,060
Net cash used in investing activities	<u>(1,278,257)</u>	<u>(300,284)</u>
Financing Activities		
Increase (decrease) in checks in process of clearing	(249,919)	300,800
Net payments under line-of-credit agreement	(1,343,274)	(173,811)
Distributions to members	(5,560,712)	(2,984,892)
Principal payments on long-term debt and capital leases	(784,805)	(1,108,574)
Proceeds from issuance of long-term debt	695,000	-
Net cash used in financing activities	<u>(7,243,710)</u>	<u>(3,966,477)</u>
Change in Cash	-	-
Cash, Beginning of Year	-	-
Cash, End of Year	<u>\$ -</u>	<u>\$ -</u>
Supplemental Cash Flows Information		
Interest paid	\$ 268,761	\$ 285,252
Debt incurred for business acquisition	119,513	-
Capital lease obligation incurred for property and equipment	320,684	78,804

**Deaconess Women's Hospital of
Southern Indiana, LLC
d/b/a The Women's Hospital**

**Notes to Financial Statements
December 31, 2007 and 2006**

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

Deaconess Women's Hospital of Southern Indiana, LLC, d/b/a The Women's Hospital (Hospital), primarily earns revenues by providing obstetrical, gynecological and nursery care on an inpatient and outpatient basis to women in Evansville, Indiana and surrounding communities. The Hospital is organized as a limited liability company; therefore, taxable income or loss is reported to the individual members of the corporation for inclusion in their respective tax returns.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Supplies

The Hospital states supply inventories at the lower of cost, determined using the first-in, first-out method or market.

Property and Equipment

Property and equipment are depreciated over the estimated useful life of each asset. Leasehold improvements are amortized over the shorter of the lease term or the estimated useful lives of the improvements. Annual depreciation is primarily computed using straight-line methods.

Charity Care

The Hospital provides care without charge or at amounts less than its established rates to patients meeting certain criteria under its charity care policy. Charity care is not reported as revenue. Charges excluded from revenue under the Hospital's charity care policy were \$250,037 and \$345,286 for 2007 and 2006, respectively.

Checks in Process of Clearing

The Hospital has an arrangement with a bank whereby any cash held at the end of each banking day is swept against the line of credit (see Note 4), causing bank balances to zero out each day. The arrangement also directs the bank to transfer cash from the line of credit to the cash accounts to pay checks as they are processed through the bank. The result is a credit amount in the cash account, which represents checks written by the Hospital but not yet processed by the bank.

**Deaconess Women's Hospital of
Southern Indiana, LLC
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**Notes to Financial Statements
December 31, 2007 and 2006**

Self Insurance

The Hospital has elected to self insure certain costs related to employee health and accident benefit programs. Costs resulting from noninsured losses are charged to expense when incurred. The Hospital has purchased insurance that limits its exposure for individual claims to \$45,000.

Hospital management has accrued an amount it believes reasonable to cover incurred but not reported claims. It is reasonably possible these estimates could change materially in the near term.

Patient Accounts Receivable

Patient accounts receivable are stated at net realizable amounts from patients, third-party payers and others for services rendered. The Hospital provides an allowance for doubtful accounts, which is based upon a review of outstanding receivables, historical collection information and existing economic conditions. Patient accounts receivable are ordinarily due 30 days after the issuance of the patient statement. Balances past due more than 120 days are considered delinquent. Delinquent receivables are written off based on individual credit evaluation and specific circumstances of the patient or third-party payer.

Physician Note Receivable

Under an agreement with a physician, the Hospital advanced amounts to the physician for their establishment of an independent physician practice. The unsecured note bore interest at a variable interest rate.

Goodwill

Goodwill is tested annually for impairment. If the implied fair value of goodwill is lower than its carrying amount, a goodwill impairment is indicated and goodwill is written down to its implied fair value. Subsequent increases in goodwill value are not recognized in the financial statements.

Income Taxes

The Hospital's members have elected to have the Hospital's income taxed as an "S" Corporation under provisions of the Internal Revenue Code and a similar section of the state income tax law. Therefore, taxable income or loss is reported to the individual members for inclusion in their respective tax returns and no provision for federal and state income taxes is included in these statements.

**Deaconess Women's Hospital of
Southern Indiana, LLC
d/b/a The Women's Hospital**

**Notes to Financial Statements
December 31, 2007 and 2006**

Note 2: Net Patient Service Revenue

The Hospital has agreements with third-party payers that provide for payments to the Hospital at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payers. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. These payment arrangements include:

Managed care. The Hospital has entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

Medicaid. Inpatient services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge. Outpatient reimbursement is based on prospectively established fee schedule allowances and rates for surgery groups.

The Hospital qualifies as a Medicaid Disproportionate Share Hospital (DSH) provider under Indiana Law and, as such, is eligible to receive DSH payments. The amounts of these additional DSH funds are dependent on regulatory approval by agencies of the federal and state governments and is determined by level, extent and cost of uncompensated care (as defined) and various other factors. DSH payments have been made by the state of Indiana, and the Hospital records such amounts as revenue when it has been reasonably determined that the funds will be received. The Hospital recognized \$2,169,419 and \$691,948 of net patient service revenue related to the DSH program for the years ended December 31, 2007 and 2006, respectively.

In May of 2007, the Centers for Medicare and Medicaid issued a final ruling that may change the state of Indiana's ability to operate the DSH program as described above. Upon enactment of this final ruling, Congress issued a one year moratorium on the ruling, which is scheduled to expire in May 2008. It is unknown if the moratorium will be extended, or what the financial implications to the DSH program in the event the moratorium is not extended.

Effective January 1, 2008, the State of Indiana began operating an insurance plan for the benefit of Indiana residents without health insurance. The plan, referred to as the Healthy Indiana Plan (HIP), will be funded through an additional state cigarette tax and with the use of a portion of the DSH funds described above. As such, the level of future DSH payments may also be negatively affected.

Approximately 90% of net patient service revenues are from participation in Managed Care and state-sponsored Medicaid program for the years ended December 31, 2007 and 2006. Laws and regulations governing the Medicaid program are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

**Deaconess Women's Hospital of
Southern Indiana, LLC
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**Notes to Financial Statements
December 31, 2007 and 2006**

Note 3: Concentration of Credit Risk

The Hospital grants credit without collateral to its patients, most of whom are area residents and are insured under third-party payer agreements. The mix of receivables from patients and third-party payers at December 31 were:

	<u>2007</u>	<u>2006</u>
Medicare	1%	2%
Medicaid	15	18
Other third-party payers	74	68
Patients	<u>10</u>	<u>12</u>
	<u>100%</u>	<u>100%</u>

Note 4: Line of Credit

The Hospital has a \$3,000,000 revolving line of credit expiring in 2008. At December 31, 2007, there were no borrowings under this line of credit. At December 31, 2006, there was \$1,343,274 borrowed against this line of credit. The line of credit is collateralized by substantially all of the Hospital assets. Interest varies with the London Inter Bank Offer Rate (LIBOR) plus 120 to 220 basis points depending upon financial performance and is payable monthly. The interest rate was 6.20% and 6.55% on December 31, 2007 and 2006, respectively.

Note 5: Long-Term Debt

	<u>2007</u>	<u>2006</u>
Note payable, bank (A)	\$ 663,327	\$ -
Capital lease obligations (B)	1,170,531	1,181,767
Note payable, bank (C)	1,074,631	1,495,843
Note payable (D)	<u>119,513</u>	<u>-</u>
	3,028,002	2,677,610
	<u>917,744</u>	<u>631,604</u>
Less current maturities	<u>\$ 2,110,258</u>	<u>\$ 2,046,006</u>

**Deaconess Women's Hospital of
Southern Indiana, LLC
d/b/a The Women's Hospital**

**Notes to Financial Statements
December 31, 2007 and 2006**

- (A) Due October 2012; payable \$14,758 monthly including interest at 6.64%; secured by substantially all assets of the Hospital. In connection with this note payable to the bank and the note reference in (C) below, the Hospital is required to comply with certain financial covenants.
- (B) Capital leases include leases for various equipment for terms ranging from 5 to 20 years. The leases assume an imputed interest rate of 1.77% to 8.25%. The leases are payable in monthly installments ranging from \$2,682 to \$6,332 and are secured by the leased equipment.
- (C) Due March 2010; payable \$42,110 monthly including interest at 5.7%; secured by substantially all assets of the Hospital.
- (D) During 2007, the Hospital acquired a therapy organization resulting in a purchase agreement of \$350,000. \$230,487 was paid by the Hospital in 2007 with the remaining balance due in two installments; \$75,000 due in 2008 and \$44,513 due in 2009. This note charges no interest.

Aggregate annual maturities of long-term debt and payments on capital lease obligations at December 31, 2007, were:

	Long-Term Debt (Exc. Leases)	Capital Lease Obligations
2008	\$ 667,101	\$ 338,543
2009	674,445	338,503
2010	292,934	275,846
2011	167,318	220,745
2012	55,673	124,053
Thereafter	-	141,588
	<u>\$ 1,857,471</u>	<u>1,439,278</u>
Less amount representing interest		<u>268,747</u>
Present value of future minimum lease payments		<u>\$ 1,170,531</u>

**Deaconess Women's Hospital of
Southern Indiana, LLC
d/b/a The Women's Hospital
Notes to Financial Statements
December 31, 2007 and 2006**

Property and equipment include the following property under capital leases:

	<u>2007</u>	<u>2006</u>
Equipment	\$ 1,874,528	\$ 1,707,992
Less accumulated depreciation	<u>897,435</u>	<u>701,891</u>
	<u>\$ 977,093</u>	<u>\$ 1,006,101</u>

Note 6: Operating Leases

Noncancellable operating leases for the building and equipment expire at various dates through 2030. The leases require the Hospital to pay all executory costs (property taxes, maintenance and insurance).

Future minimum lease payments at December 31, 2007, were:

2008	\$ 3,342,780
2009	3,124,330
2010	3,101,754
2011	2,983,668
2012	3,023,005
Later years	<u>61,449,458</u>
	<u>\$ 77,024,995</u>

Rent expense for all operating leases was \$3,350,324 and \$3,375,445 for the years ended December 31, 2007 and 2006, respectively.

Note 7: Profit-Sharing Plan

The Hospital has a 401(k) profit-sharing plan (Plan) covering substantially all employees. The Hospital's contributions to the Plan are determined annually by the board of managers. Contributions to the Plan were \$344,578 and \$279,442 for 2007 and 2006, respectively.

**Deaconess Women's Hospital of
Southern Indiana, LLC
d/b/a The Women's Hospital
Notes to Financial Statements
December 31, 2007 and 2006**

Note 8: Deferred Compensation Agreement

The Hospital has a deferred compensation agreement with the chief executive officer that provides certain benefits upon disability or retirement. The present value of total estimated deferred compensation is being accrued using the straight-line method over the remaining years to the full eligibility date. Expense for 2007 and 2006 was \$12,053 and \$24,106, respectively.

Note 9: Related-Party Transactions

Deaconess Hospital, Inc. (DHI) owns 50% of the Hospital. The Hospital engages in various transactions with DHI which are summarized below.

- Capital lease arrangements - The Hospital leases various equipment under capital lease arrangements from DHI. Payments related to these leases totaled \$149,189, including imputed interest for 2007 and 2006. Amounts owed at December 31, 2007 and 2006, totaled \$650,371 and \$741,769, respectively, and the net book value of the related equipment was \$469,550 and \$556,343 for 2007 and 2006, respectively. These leases are also included and described in Note 5.
- Operating lease arrangements - The Hospital leases its hospital, education and office space from DHI under noncancellable leases ranging from 10 to 30 years. Total payments under these arrangements were \$2,792,867 and \$2,747,395 in 2007 and 2006, respectively. These leases are also included and described in Note 6.
- Other services - The Hospital contracts with DHI for pharmacy, lab, transcription, coding and other services. Payments made to DHI under these agreements totaled \$2,393,347 and \$2,262,754 in 2007 and 2006, respectively. Amounts payable for these services at year end totaled \$688,136 and \$721,936 in 2007 and 2006, respectively.

Note 10: Malpractice Claims

The Hospital is a qualified health care provider under the Indiana Medical Malpractice Act and is fully insured under a claims-made policy on a fixed premium basis. The Indiana Medical Malpractice Act limits a qualified provider's liability for an occurrence to the amount of required insurance. The Indiana patient compensation fund is liable for the excess up to an overall damage cap. Accounting principles generally accepted in the United States of America requires a health care provider to accrue the expense of its share of malpractice claim costs, if any, for any reported and unreported incidents of potential improper professional service occurring during the year by estimating the probable ultimate costs of the incidents. Based upon the Hospital's claim experience, no such accrual has been made. It is reasonably possible that this estimate could change materially in the near term.

**Deaconess Women's Hospital of
Southern Indiana, LLC
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Notes to Financial Statements
December 31, 2007 and 2006**

Note 11: Significant Estimates and Concentrations

Accounting principles generally accepted in the United States of America requires disclosure of certain significant estimates and current vulnerabilities due to certain concentrations. Those matters include the following:

Allowance for Net Patient Service Revenue Adjustments

Estimates of allowances for adjustments included in net patient service revenue are described in Notes 1 and 2.

Admitting Physicians

The Hospital is served by one group of admitting physicians whose patients comprise approximately 31% of the Hospital's net patient service revenue.

Deferred Compensation Agreement

As described in Note 8, the amount of annual expense accrued for deferred compensation is based on an estimate of the total amounts payable under the contract over the lifetime of the beneficiary.

Note 12: Business Acquisition

In October 2007, the Hospital acquired the business of a niche physical therapy operation that provides physical therapy to infants in the neonatal intensive care unit, among other patients. The aggregate purchase price was \$350,000, including the approximately \$54,200 of certain therapy equipment, which is included in property, plant and equipment, resulting in \$295,800 in goodwill, which is expected to be deductible for tax purposes. The results of operations since the acquisition date are included in these financial statements.



Board of Managers and Management
Deaconess Women's Hospital of
Southern Indiana, LLC
Newburgh, Indiana

In planning and performing our audit of the combined financial statements of The Women's Hospital (Hospital) as of and for the year ended December 31, 2007, in accordance with auditing standards generally accepted in the United States of America, we considered the Hospital's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control. Accordingly, we do not express an opinion on the effectiveness of the Hospital's internal control. As such, our consideration of internal controls would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements of the Hospital's financial statements on a timely basis. A control deficiency in design exists when a control necessary to meet a control objective is missing or an existing control is not properly designed so that, even if the control operates as designed, a control objective is not always met. A control deficiency in operation exists when a properly designed control does not operate as designed or when the person performing the control does not possess the necessary authority or qualifications to perform the control effectively.

A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Hospital's ability to initiate, authorize, record, process or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Hospital's financial statements that is more than inconsequential will not be prevented or detected.

A material weakness is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the Hospital's financial statements will not be prevented or detected by the Hospital's internal controls.

We observed the following matters that we consider to be control deficiencies, significant deficiencies or material weaknesses. Previously, we made observations as a result of our 2006 audit engagement in a letter dated February 20, 2007.

Material Weaknesses

No matters are reportable.

Significant Deficiencies

No matters are reportable.

Control Deficiencies

Internal Controls Over Cash Disbursements Cycle

Within the cash disbursements cycle, the Controller has the ability to approve payments, sign checks and record disbursements. The mitigating factors include the Controller not being responsible for reconciling the bank account and not having the ability to generate a check within the computer system. Additionally, all checks greater than \$10,000 require dual signatures.

Information Technology Personnel

During the audit, BKD noted that certain IT personnel are currently not prohibited from engaging in user activities such as data entry, processing and approving transactions in the finance area. Additionally, IT personnel have the ability to initiate and authorize business transactions along with initiating changes in master files. BKD recommends that management review the abilities of IT personnel and further segregate functions of the IT and finance department.

This letter is intended solely for the information and use of the Finance Committee, the Board of Managers and management and is not intended to be and should not be used by anyone other than these specified parties.

BKD, LLP

February 13, 2008